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Wealth Advisors LLC
Plan • Advise • Protect

7 Keys to Successful Wealth Management for Canadians Living in the US

White Paper

Stuart Campbell TEP

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About Campbell Wealth Advisors

Phone: (952) 474-1270
Email: stuart@campbellfinancial.net
Website: campbellwa.com
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Introduction

The similarities in culture, language, and lifestyle between Canada and the United States lead many to believe moving to the U.S. is a simple transition and doesn't require advanced planning. But the complexities associated with such a move are astounding.

The fact is many Canadians that move to the U.S. struggle to understand the intricacies and issues associated with cross-border wealth and retirement planning. This lack of understanding can lead to costly financial mistakes, double taxation, and non-compliance with legislation, such as FACTA and FBAR.

Individuals living in the U.S. with assets in both countries have complicated wealth-planning issues. They need expert guidance to manage their cross-border investments and retirement plans. For this reason, we recommend these individuals work with a team of experts in the areas of taxation, estate planning, immigration law, and cross-border financial planning.

Differences in Taxation, Investing, Healthcare, and Estate Planning are profoundly different in the U.S. compared to Canada.

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Email: stuart@campbellfinancial.net
Website: campbellwa.com
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Our Solution

We help clients understand the issues and complexities involved in the management of cross-border assets and, ultimately, in the development of a cross-border retirement plan. Our team guides each client through a systematic financial-planning process, which often entails:

Step 1: Learning about the client's financial situation, U.S. immigration status, family members, and other tax and legal advisors.

Step 2: Assessing the client's U.S. residence plans, as well as retirement and estate planning goals. We analyze all investment accounts, estate plans, insurance policies, and family needs to develop strategies to efficiently manage wealth.

Step 3: Developing a written plan that details the client's entire financial picture. The plan also includes recommendations and strategies on how to manage cross-border wealth to meet his or her unique goals.

Step 4: Once the plan is approved, we then move to implementation. At every stage of the process, we educate and involve the client to help him or her make prudent financial decisions.

Ongoing: We continually monitor the client's plans and make changes as needed.

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Key #1 - RRSP Accounts for U.S. Residents

If you moved to the U.S. from Canada and left your Registered Retirement Savings Plan (RRSP) in Canada, you might be wondering if you have to pay U.S. taxes on withdrawals from your Canadian registered plan. You may also be wondering if you must pay taxes to the Canada Revenue Agency (CRA).

The answer: You may have a tax liability to the IRS, and you'll be subject to CRA withholding tax of 25% on lump sum withdrawals and 15% on periodic payments.

But the question you should be asking yourself is…

> ***"Why have I left my RRSP, RIF, or LIRA accounts in Canada? And what are the issues in doing so?"***

First, let's review the CRA's position on RRSP accounts held by a non-resident.

RRSP accounts aren't considered capital property and aren't "deemed" disposed of on departure. These accounts can remain in Canada and grow tax deferred until withdrawal. No additional contributions can be made to the account.

Yes, you can leave your registered accounts in Canada…but should you?

The following are some of the issues with holding Canadian RRSP accounts as a U.S. resident:

- **Withdrawl withholding**. You're subject to not only the tax rules but any changes made to these rules in both Canada and the U.S. For example, Canada once withheld 15% on lump sum withdrawls. Today, the withholding is 25%. Will this change again in the future?

- **Foreign tax credits**. The Canada-U.S. tax treaty allows you to take a foreign tax credit for the tax withheld by the CRA when the RRSP plan holder is alive. These credits can be carried forward 10 years. However, the treaty does not provide for a credit of the withholding tax at death against the estate tax in the U.S.

- **Capital gains taxation**. RRSP investors who invest in appreciating assets such as stocks or growth mutual funds will almost always face a double tax on all their capital gains. This is a result of the IRA taxing the gains on the RRSP account *and* the CRA withholding tax.

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Issues with holding Canadian RRSP accounts as a U.S. resident (continued):

- **Estate plan structure**. Your U.S. estate plan cannot be designed to adequately deal with Canadian RRSP accounts.
- **Currency speculation**. Where are you going to retire? If you're going to retire in the U.S., you'll likely need and want to spend U.S. dollars? At the time of retirement, where is the Canadian dollar going to be compared to the U.S. dollar?
- **Investment options and fees**. The U.S. is the largest capital market in the world. As an investor, you have more choices with lower fees and lower transaction costs on your investment accounts compared to Canada.
- **Canadian broker licensures**. As a U.S. resident, you're subject to Security Exchange Commission (SEC) rules. Your Canadian broker or investment firm must be licensed in your state to legally transact security trades for you. This means you may be stuck with your current stocks and mutual funds, unable to change investments or react to changing market conditions — not an ideal situation to be in for any investor.
- **Filing requirements**. You're also subject to both Foreign Bank Account Report (FBAR) and Internal Revenue Service (IRS) filing requirements every year you hold foreign investment accounts.

Key #2 - Estate Planning for U.S. Canadians

U.S. citizens or non-citizen domiciliary are subject to U.S. estate and gift tax on their WORLDWIDE assets.

However, the application of the U.S. transfer tax regime may be more complex (and even more onerous) for a non-U.S. citizen than a U.S. domicile.

Ouch, do you have a headache yet?

For Canadians living in the U.S., the area of estate planning is extremely complex, and it deserves much more attention than we can provide in this whitepaper. But we'd still like to use the available space to offer you a couple suggestions.

First off, it's best to use a qualified attorney rather than a do-it-yourself will or trust kit. Second, it's advisable to employ a team approach with an experienced cross-border financial planner as the quarterback. This can ensure an appropriate estate plan is developed for your unique situation.

We have a network of experts, lawyers, and accountants with experience in estate planning for non-citizens that we can recommend to you.

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Key #3 – Social Benefit Claiming Strategies

How to coordinate and maximize your social benefits, including U.S. Social Security, Canada Pension Plan, Old Age Security, and/or Quebec Pension Plan.

For many Canadians living in the U.S., one of the main objectives in cross-border financial planning is to collect both a Canadian social benefit plan and U.S. Social Security — if, of course, you qualify.

Qualifying for and coordinating these benefits often requires long-term planning. In fact, collecting Canadian benefits while a U.S. resident comes with significant income tax advantages, which we'll get into later.

Currently, Canada offers three social benefit retirement plans:

1. **Canada Pension Plan (CPP)**. To qualify for this benefit, you must be employed in Canada for 10 years or more. If you exit Canada, you're still entitled to this benefit.
2. **Old Age Security (OAS)**. For this benefit, you must be a resident of Canada for at least 40 years past the age of 18. Any less than this, and the benefit will be reduced.
3. **Quebec Pension Plan (QPP)**. Qualifying for this benefit requires you to have contributed to QPP for at least 1 year. If you no longer live in Quebec, you're still entitled to this benefit.

The United States, on the other hand, has just one social retirement benefit plan:

1. **Social Security**. To qualify for this benefit, you need at least 40 quarters of work as a U.S. person. As a side note, the spouse of a qualifying person is entitled to up to 50% of the primary insurance amount (PIA) at full retirement age (FRA).

Because the U.S. entered into a Social Security Agreement with Canada, a Canadian moving to the U.S. can qualify for a minimal social benefit in as few as 18 months.

Windfall Elimination Provision

Social Security has a reduction clause known as the Windfall Elimination Provision (WEP), which reduces a person's benefit if they've earned pensions that didn't withhold Social Security taxes, such as government agencies or pensions earned outside the United States.

However, that Canada-U.S. Social Security Agreement provides the coordination of benefits for citizens spending time in both countries. The goal was to avoid disadvantaging citizens by any loss of benefits. Part of this agreement includes the WEP.

While it essentially overrides the clause, Social Security administrators are often unaware of the agreement, and they apply WEP, reducing the Social Security benefits of Canadian living in the U.S. As a result, you'll need to work with a cross-border advisor to help ensure you're getting all benefits entitled to you.

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Key #4 – Understanding FACTA Obligations

The **Foreign Account Tax Compliance Act** (FATCA) was brought about by the U.S. to combat tax evasion by U.S. persons holding offshore accounts and financial assets.

Under FATCA, U.S. taxpayers holding financial assets outside the United States must report those assets to the IRS on Form 8938, a Statement of Specified Foreign Financial Assets. This FATCA requirement is in addition to the long-standing requirement to report foreign financial accounts on FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), and **not reporting foreign financial assets comes with serious penalties**.

FATCA also requires certain foreign financial institutions to report information about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest directly to the IRS. The reporting institutions will include not only banks but other financial institutions, such as investment entities, brokers, and certain insurance companies. Some non-financial foreign entities will also need to report certain information about their U.S. owners.

The information listed is just a short description of FACTA reporting for U.S. taxpayers. Make yourself aware of your reporting obligations, as non-compliance is punitive and costly.

The Treasury Department and IRS continue to develop guidance concerning FATCA. For current and more in-depth information, please visit FATCA.

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Key #5 – Implications of a Canadian Address

Leaving your old Canadian address, or that of a family member, on file for a Canadian-based investment account may not seem like an issue. But the IRS and the Canada Revenue Agency (CRA) share information, and this **oversight could lead either country to challenge your residency status**, potentially causing double taxation.

Once you're a U.S. resident and a non-resident of Canada, you're no longer obligated to file Canadian tax returns. Withdrawals from Canadian accounts are only subject to Part XIII withholding tax. If, however, your residency status is challenged and Canada deems you a resident, you'll be subject to filing a Canadian tax return and pay income tax on your Canadian earnings.

To avoid **double taxation issues and duplication of investment costs**, always make certain to:

1. **Double check withholding tax**. Ensure that the correct amount of withholding tax is applied to all of your investments.

2. **Pay attention to investment structures**. Structure Canadian and U.S. investment accounts to complement one another.

3. **Update accounts to reflect U.S. address**. Never leave an old Canadian address on file as the address of record for Canadian-based investments.

If you continue to hold Canadian assets through banks, investment accounts, corporations, or real estates, there are strict U.S. disclosure documents that must be filed annually with the IRS, as discussed in the FACTA section.

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Key #6 – Understanding Passive Foreign Investment Companies

Canadians holding offshore investment accounts while residents of the United States should familiarize themselves with something known as **Passive Foreign Investments Companies** (PFIC).

These "pooled investments" registered outside the U.S. typically encompass **Canadian-traded mutual funds and exchange-traded funds** (ETFs), but PFICs may also include other financial products, such as hedge funds, insurance products, and non-U.S. pension plans. Sometimes, it may even comprise of a bank account if it's a money-market fund rather than a straight deposit account, as money-market accounts are essentially short-maturity fixed-income mutual funds.

Furthermore, PFIC rules often apply to investment held inside foreign pension funds unless the U.S. recognizes these plans as "qualified" under the terms of a double-taxation treaty between the U.S. and the host country.

Potential Issues for PFICs

Holding PFICs can lead to very harsh income tax consequences, as the tax treatment for PFICs is extremely punitive compared to the tax treatment of similar investments incorporated in the U.S.

For example, a U.S. holder of a U.S. incorporated mutual fund pays the low long-term capital gains rate of 15% if held for more than one year. When that same U.S. investor buys a nearly identical fund listed in Canada (*or any place outside the US*), he'll find his investment subject to the PFIC taxation regime, which counts all income, including capital gains, as ordinary income and automatically taxes it at the top individual tax rate. In some cases, the total tax on a PFIC could be well above 50%. Compounding the issue is capital losses, which cannot be carried forward or used to offset other capital gains.

In addition to punitive tax treatment, all non-U.S. investment accounts are subject to FACTA compliance, which comes with its own reporting, disclosure, and compliance obligations.

Besides the tax implications and FACTA obligations, you must pay close attention to the licensure of your Canadian broker or investment firm. If the broker of firm isn't licensed in the U.S. and you're subject to SEC rules as a U.S. resident, you could find your account frozen, and you're now unable to give trading instructions.

The PFIC rules are just one of many reasons why U.S.-resident investors should keep investment funds in U.S. accounts. Even when investing globally, it's just good practice to keep these funds in U.S. accounts. A thorough analysis of the tax, cost, reporting, and security issues invariably leads to the conclusion that when it comes to wise and efficient investing, savvy U.S.-resident investors keep their wealth invested globally, but through U.S. financial institutions.

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Key #7 – Understanding U.S. Life Insurance Taxation

Many Canadians moving to the United States don't often realize how different life insurance is taxed in the U.S. as compared to Canada.
It isn't uncommon for Canadians moving across the border to live or work in the U.S. to hold life insurance or other living benefits insurance contracts in Canada. These contracts can create unanticipated and, in some situations, adverse tax consequences.

Currently, Canadian residents aren't subject to gift or estate taxes, and the proceeds of life insurance death benefits are paid free of tax. The same, however, can't be said for U.S. citizens and permanent residents.

At this time, **citizens and permanent residents of the United States are subject to gift and estate taxes**. Though the proceeds of life insurance death benefits may be paid free of tax, they are include in the deceased estate and could be subject to estate taxes.

Complexities of Canadian Policies

It's these differences in taxation that can add more complexity to the potential tax issues with life insurance policies.

Take, for example, many successful Canadian business professionals. They often own life insurance in a Canadian controlled private corporation (CCPC) to take advantage of the CDA rules. When they move to the United States and become a non-resident of Canada, they lose this tax advantage.

By comparison, many successful U.S. business professionals hold life insurance in an Irrevocable Life Insurance Trust (ILIT) to minimize U.S. estate tax. Your Canadian-issued life insurance contracts may not be eligible in a U.S. ILIT. It may be subject to taxable distribution if ownership were to change.

In addition to the disparity in the tax treatment of death benefits, the tax rules that govern the taxation of the cash value and the amount of tax-free deferral of the cash reserves for the policies are different between the two countries.

Careful analysis of your life insurance policies, ownership structures, and tax status needs to be included in your cross-border plan to minimize punitive tax treatment of this valuable benefit.

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Conclusion

Canadians pulling up stakes for the United States must realize that it's more than a simple change in address. The move can have serious ramifications on everything from wealth management and retirement planning to income tax and insurance benefits. It takes careful consideration and advanced planning to avoid financial inaccuracies, double taxation, and non-compliance of reporting and disclosure obligations.

Understanding your tax liability, claiming strategies for benefits, and potential issues in holding certain investment accounts can help. But it doesn't eliminate the complexities associated with cross-border wealth management and retirement planning. This often requires a team of experts led by an experienced cross-border financial planner.

With this approach, you're working with a team that understands how one system affects and interacts with the others, helping to establish financial, retirement, and estate plans that minimize risk, alleviate taxation, and better manage wealth. What's more, each is specific to your unique situation.

About Campbell Wealth Advisors

Campbell Wealth Advisors is a boutique independent financial services firm out of the greater Minneapolis-St. Paul area, providing cross-border expertise and a global perspective to financial planning, wealth management, retirement income and estate planning, business succession tactics, and advanced life insurance strategies.

For more than 25 years, we've been helping our clients protect their wealth and build their financial futures by educating and empowering them through smart planning and expert advice focused on what they find important.

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